DEPARTMENT O F STATE REVENUE

LETTER OF FINDINGS NUMBER 99-0460

GROSS RETAIL AND USE TAX
FOR THE PERIOD 1995–97

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ISSUES

The Department restates the issue the taxpayer has raised into the following issues:

I. Gross Retail and Use Tax—Status of Personal Property as Tangible or Intangible—"Pre-Written," "Canned" or "Off-the-Shelf" Software

Authority: 17 U.S.C. §§ 101 and 202 (1994 and 2000); I.R.C. (26 U.S.C.) § 38 (1988 and 1994); IC §§ 6-2.5-3-1(a), -2(a) (1993); *Stephens v. Cady*, 55 U.S. (14 How.) 528 (Dec. Term 1852); *Williams Elecs., Inc. v. Artic Int'l, Inc.*, 685 F.2d 870 (3d Cir. 1982); *Norwest Corp. v. Commissioner*, 108 T.C. 358 (U.S. Tax Ct. 1997); *Wal-Mart Stores, Inc. v. City of Mobile*, 696 So.2d 290 (Ala. 1996); *Bernstein v. Glavin*, 725 N.E.2d 455 (Ind. Ct. App.), *trans. denied* 741 N.E.2d 1248 (Ind. 2000); *South Cent. Bell Tel. Co. v. Barthelmy*, 643 So.2d 1240 (La. 1994); *Comptroller of the Treasury v. Equitable Tr. Co.*, 464 A.2d 459 (Md. 1983); *First Data Corp. v. Nebraska Dep't of Revenue*, 639 N.W.2d 898 (Neb. 2002); *A & D Tech. Supply Co. v. Nebraska Dep't of State Revenue*, 607 N.W.2d 857 (Neb. 2000); *Hasbro Indus., Inc. v. Norberg*, 487 A.2d 124 (R.I. 1985); *Citizens and S. Sys., Inc. v. South Carolina Tax Comm'n*, 311 S.E.2d 717 (S.C. 1984); *South Cent. Utah Tel. Ass'n, Inc. v. Auditing Div.*, 951 P.2d 218, 224 (Utah 1997); *Chittenden Tr. Co. v. King*, 465 A.2d 1100 (Vt. 1983); *Pennsylvania and W. Va. Supply Corp. v. Rose*, 368 S.E.2d 101 (W. Va. 1988); Sales Tax Information Bulletin # 8 (1990)

The taxpayer argues that the software transactions in issue involved nontaxable licenses of intangible personal property, rather than leases of taxable tangible personal property.

II. Gross Retail and Use Tax—Retail Unitary Transactions—"Pre-Written," "Canned" or "Off-the-Shelf" Software

Authority: 17 U.S.C. §§ 101, 202 and 204(a) (1994 and 2000); IC §§ 6-2.5-1-1, -1-2, 3-2(a), -4-1 (1993); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Effects Assocs., Inc. v. Cohen*, 908 F.2d 555 (9th Cir. 1990); *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985); *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291 (5th Cir. 1980); *Shugrue v. Continental Airlines, Inc.*, 977 F. Supp. 280 (S.D.N.Y. 1997); *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994); *Colonial Life Ins. Co. v. Electronic Data Sys. Corp.*, 817 F. Supp. 235 (D. N.H. 1993); *Aplications,* [sic] *Inc v. Hewlett-Packard Co.*, 501 F. Supp. 129 (S.D.N.Y. 1980), *aff'd* 672 F.2d 1076 (2nd Cir. 1982); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 479 F. Supp. 738 (D. N.J. 1979), *aff'd and remanded* 635 F.2d 1081 (3rd Cir. 1980); *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39 (D. S.C. 1974); *Neilson Bus. Equip. Ctr., Inc. v. Monteleone,* 524 A.2d 1172 (Del. 1987); *Bernstein v. Glavin*, 725 N.E.2d 455 (Ind. Ct. App.), *trans. denied* 741 N.E.2d 1248 (Ind. 2000); *Cowden & Sons Trucking, Inc. v. Indiana Department of State Revenue*, 575 N.E.2d 718 (Ind. Tax Ct. 1991); *South Cent. Bell Tel. Co. v. Barthelmy*, 643 So.2d 1240 (La. 1994); *Austin's of Monroe, Inc. v. Brown*, 474 So.2d 1383 (La. Ct. App. 1985); *Comptroller of the Treasury v. Equitable Tr. Co.*, 464 A.2d 459 (Md. 1983); *USM Corp. v. Arthur D. Little Sys., Inc.*, 546 N.E.2d 888 (Mass. Ct. App. 1989); *Communications Groups, Inc. v. Warner Communications, Inc.*, 527 N.Y.S.2d 341 (N.Y. Civ. Ct. 1988); *Hasbro Indus., Inc. v. Norberg*, 487 A.2d 124 (R.I. 1985); *Crescent Amusement Co. v. Carson*, 213 S.W.2d 27 (Tenn. 1948); *Camara v. Hill*, 596 A.2d 349 (Vt. 1991); *Chittenden Tr. Co. v. King*, 465 A.2d 1100 (Vt. 1983); *Pennsylvania and W. Va. Supply Corp. v. Rose*, 368 S.E.2d 101 (W. Va. 1988); 45 IAC § 2.2-4-2 (1992 and 1996)

The taxpayer contends that the true object of the assessed transactions was the licensing of software, not the leasing of the tangible personal property on which the software was located.

STATEMENT OF FACTS

During calendar years 1995-97 ("the audit period") the taxpayer, an Indiana-chartered corporate manufacturer, changed the software it used at its Indiana headquarters. The taxpayer obtained copies of two non-customized software application programs (commonly referred to as "pre-written," "canned" or "off-the-shelf" software) from the same transferor, which also provided the taxpayer with consulting and training services and maintenance agreements. As evidence of the terms of the transaction, the taxpayer has tendered in evidence a "Software License Agreement" (hereinafter "the Agreement") for the copies of the applications obtained from the taxpayer's transferor, together with the addenda and attachments to that agreement. The taxpayer paid no gross retail tax at the time it obtained the copies of the software.

Relying in part on Sales Tax Information Bulletin # 8, the field auditor assessed use tax on everything obtained from the software transferor except the consulting and training charges, which the transferor had stated separately on its invoices to the taxpayer. The taxpayer timely protested the part of the proposed assessment levied on the copies of the canned software. The Department will provide additional facts below in the Discussion if and as needed.

SUMMARY OF FINDINGS

For the reasons set out below, the Department finds that the pre-written software the taxpayer obtained was tangible personal property, and as such the taxpayer's use of it was subject to tax. Accordingly, the Department sustains the assessment and denies the taxpayer's protest.

I. Gross Retail and Use Tax—Status of Personal Property as Tangible or Intangible—"Pre-Written," "Canned" or "Off-the-Shelf" Software

DISCUSSION

A. INTRODUCTION: THE TAXPAYER'S ARGUMENT

The taxpayer argues that the assessed software transactions are excluded from imposition of gross retail (i.e., sales) and use taxes. It bases its position on three propositions: first, that the Gross Retail and Use Tax Act applies only to tangible, not intangible, personal property; second, that canned software programs, and licenses of such applications, are intangible personal property; and third, that canned software programs therefore are not subject to imposition of Indiana sales or use taxes by virtue of being intangible personal property.

The taxpayer supports the first proposition by pointing to the references to tangible, and the lack of any references to intangible, personal property in several sections of the Gross Retail and Use Tax Act as evidence that it does not apply to intangible personal property. *See, e.g.*, IC § 6-2.5-3-2(a) (the use tax imposition statute). The taxpayer also construes "tangible" as being a synonym of "corporeal," and "intangible" as being a synonym of "incorporeal," citing to legal dictionary definitions of "corporeal" and "corporeal property" to support its interpretation. *See* BLACK'S LAW DICTIONARY 310 (5th ed. 1979) (defining "corporeal" and "corporeal property," and contrasting corporeal and incorporeal property). In addition, the taxpayer contends that a statute imposing a listed tax must be construed against the Department (i.e., against taxability) and in favor of the taxpayer. As authority for this position it cites *Lincoln National Life Insurance Company v. Department of State Revenu*e, [1955-1986 Transfer Binder] Ind. Tax Rep. (CCH) ¶ 200-460 (Noble County Cir. Ct. Oct. 20, 1981), [1955-1986 Transfer Binder] Ind. Tax Rep. (CCH) ¶ 200-460, Conclusion of Law 3, at 10,773.

In support of its second proposition, the taxpayer submits that off-the-shelf software programs are not corporeal, and therefore are incorporeal and intangible, as distinguished from the packages containing them. In the taxpayer's view software programs are intangible partly because they are intellectual property and partly because they are not perceivable by any of the senses. The Department infers from the latter argument that the taxpayer is referring to the unaided senses.

The taxpayer's third proposition is based on the second. Based on the premise that, in the taxpayer's view, the canned software applications and the licenses of those programs are intangible rather than tangible personal property, it contends that they are therefore also not subject to imposition of Indiana gross retail and use taxes. The taxpayer further submits that the Department made an unauthorized attempt to expand the sales and use tax imposition statutes to apply to off-the-shelf software applications by issuing Sales Tax Information Bulletin # 8, which the taxpayer submits the decision in *Lincoln National* issued shortly thereafter superseded in any case.

As supporting authority for its argument, the taxpayer cites to *Lincoln National* and to *Manpower International, Inc. v. Wisconsin Department of Revenue*, [1993-1998 Transfer Binder], Wis. Tax Rep. (CCH) ¶ 400-240 (Wis. Ct. App. Aug. 22, 1996). These opinions, of an Indiana trial court and the Wisconsin Court of Appeals, respectively, neither of which is published in the respective official state reports, each held that canned computer software is intangible rather than tangible personal property and as such not subject to sales tax. The taxpayer also cites to statutory definitions of "tangible personal property" or "corporeal personal property," all of which explicitly include computer software (usually canned, off-the-shelf or non-customized), from the gross retail and use tax laws of nine other states. The taxpayer argues that these definitions support the idea that pre-written software applications are tangible personal property, and as such are subject to state sales and use taxes, only if the legislature in question has explicitly so defined the term "tangible personal property." Since, in the taxpayer's view, the Indiana General Assembly has not done so, canned software is not "tangible personal property" the use of which is subject to Indiana use tax. The taxpayer refers to IC § 6-2.5-3-1(d), which refers to both tangible and intangible personal property, as evidence that the legislature understands the difference between them. Lastly, the taxpayer cites to IC § 6-1.1-10-39 and 50 IAC § 4.2-4-3(g)(3), and to Rev. Proc. 69-21, 1969-2 C.B. 303, all of which the taxpayer contends treat software programs as being intangible personal property or an intangible asset. The Department will refer in the following Discussion to additional details of the taxpayer's argument if and as needed.

B. THE GROSS RETAIL AND USE TAX ACT APPLIES TO TANGIBLE PERSONAL PROPERTY.

The taxpayer's first proposition, i.e. that the Gross Retail and Use Tax Act applies only to tangible personal property, is correct. IC § 6-2.5-3-2(a) in particular imposes the use tax "on the storage, use, or consumption of tangible personal property in Indiana, …." *Id.* IC § 6-2.5-3-1(a) defines "use" as "the exercise of any right or power of ownership over tangible personal property." *Id.* However, the taxpayer's second and third underlying propositions, i.e. that canned software recorded on a tangible medium is not tangible personal property and not subject to Indiana gross retail and use taxes, are wrong, as the Department will explain below.

C. COPIES OF PRE-WRITTEN SOFTWARE ARE TANGIBLE PERSONAL PROPERTY AND SUBJECT TO GROSS RETAIL AND USE TAXES.

1. "Tangible" Means Perceptible by Any Sense, Aided or Unaided.

The taxpayer's argument that things that are imperceptible to the senses are incorporeal is incorrect. It does not follow from the fact that the *unaided* senses cannot perceive something that it is incorporeal and therefore intangible. Things that cannot be so perceived are nevertheless tangible to humans because they can correct or enhance their senses with appliances and devices such as eyeglasses and contact lenses, machines such as computers, and even computer programs. For example, a personal computer user who is blind or severely visually impaired can buy or lease a software program designed to aid such people.

It therefore follows that the aided, and not just the unaided senses, determine what things are or are not corporeal and tangible to human beings. Reported sales and use tax opinions on computer software from several other states recognize this point. In *South Central Bell Telephone Co. v. Barthelmy,* 643 So.2d 1240 (La. 1994), the court observed:

> In defining tangible, "seen" is not limited to the unaided eye, "weighed" is not limited to the butcher or bathroom scale, and "measured" is not limited to a yardstick. … *That we use a read/write head to read the magnetic or unmagnetic spaces [on media containing a computer program] is no different than any other machine that humans use to perceive those corporeal things which our naked senses cannot perceive.*

Id. at 1246 (internal quotation marks omitted; emphasis added). The court then went on to hold that a copy of a canned computer software program is corporeal, and as such is tangible personal property subject to use tax. *Id*. at 1246 and 1250, respectively. At least four other state courts of last resort had already held copies of off-the-shelf software to be tangible and taxable. *Hasbro Indus., Inc. v. Norberg,* 487 A.2d 124, 128-29 (R.I. 1985); *Citizens and S. Sys., Inc. v. South Carolina Tax Comm'n*, 311 S.E.2d 717, 719 (S.C. 1984); *Chittenden Tr. Co. v. King*, 465 A.2d 1100, 1101 (Vt. 1983); and *Pennsylvania and W. Va. Supply Corp. v. Rose*, 368 S.E.2d 101, 104 (W. Va. 1988). They did so by construing statutory definitions of "tangible personal property" essentially the same as the definition of "corporeal" the present taxpayer cites, but without the "unaided-senses" gloss that the taxpayer has implied. In addition, since the Louisiana Supreme Court issued *South Central Bell*, the supreme courts of three other states have followed it to reach the same result that opinion did. *Wal-Mart Stores, Inc. v. City of Mobile*, 696 So.2d 290, 291 (Ala. 1996), *overruling State v. Central Computer Servs., Inc.*, 349 So.2d 1160 (Ala. 1977); *First Data Corp. v. Nebraska Dep't of Revenue*, 639 N.W.2d 898, 904 (Neb. 2002), construing *A & D Tech. Supply Co. v. Nebraska Dep't of State Revenue*, 607 N.W.2d 857, 866 (Neb. 2000); *South Cent. Utah Tel. Ass'n, Inc. v. Auditing Div.*, 951 P.2d 218, 224 (Utah 1997). There is thus a significant body of persuasive judicial precedent from other states, contrary to the taxpayer's position, that holds that pre-written software is corporeal and tangible for sales and use tax purposes.

Neither *Lincoln National* nor *Manpower International* is valid authority to the contrary. As previously noted, neither opinion has appeared in the official court reporters of Indiana or Wisconsin, respectively. *Lincoln National* is a trial court judgment from which no appeal was taken. Although the Indiana Supreme Court has not ruled on the question, a majority of the panels of the Indiana Court of Appeals have held that a cited unpublished judgment has no effect as precedent. "[A] conclusion of law by a circuit court in a case from which no appeal has been taken is not binding precedent …." *Indiana Dep't of Natural Resources v. United Minerals, Inc.*, 686 N.E.2d 851, 857 (Ind. Ct. App. 1st Dist. 1997). *Accord, Hartford Acc. & Indem. Co. v. Dana Corp.*, 690 N.E.2d 285, 294 n.10 (Ind. Ct. App. 2d Dist. 1997) (quoting *United Minerals*) and *Indiana High School Athletic Ass'n v. Durham*, 748 N.E.2d 404, 413 n.5 (Ind. Ct. App. 5th Dist. 2001) (citing *United Minerals*). By the same logic, an unpublished trial court decision in a tax case could not overrule Sales Tax Information Bulletin # 8. Nor does an unpublished opinion of an appeals court of another jurisdiction, cited as precedent contrary to policies embodied in the Indiana Rules of Appellate Procedure and the rules of the issuing court. See Ind. R. App. P. 65D (2001), former Ind. R. App. P 15(A)(3) (1972) (repealed 2001) and Wis. Stat. § 809.23(3) (Cum. Supp. 2001) (each stating in substance that unpublished opinions may only be cited by the parties to that case to establish claim or issue preclusion or law of the case). *See also Miller Brewing Co. v. Best Beers of Bloomington, Inc.*, 579 N.E.2d 626, 633 n.4 (Ind. Ct. App. 1st Dist. 1991) (stating that citing an unpublished federal district court opinion was inappropriate under both the Indiana Rules of Appellate Procedure and the local appellate rules for the circuit covering the district court). Citing to such authorities on appeal is inappropriate. *United Minerals*, 686 N.E.2d at 857 n.1; *Hartford Acc. & Indem. Co.*, 690 N.E.2d at 294 n.10, citing *United Minerals.*

Nor do the taxpayer's citation to IC § 6-1.1-10-39 or 50 IAC § 4.2-4-3(g)(3), or its selective citations to statutory definitions of "tangible personal property" in the sales and use tax laws of other states support its argument. As regards IC § 6-1.1-10-39 and 50 IAC § 4.2-4-3(g)(3), it is important to emphasize that the issue in this protest is whether this Department is correct in levying use tax on the taxpayer under IC § 6-2.5-3-2(a) on its use of the copies of the software in question. The issue is not whether the taxpayer's possession of those copies subjected it to property tax, which this Department does not even administer.

The fact that a few states may have statutorily defined "tangible personal property" to explicitly include computer software has no relevance whatever to resolving the question of whether the Indiana legislature, by failing to do so in recodifying the Gross Retail and Use Tax Act, intended to exclude software from the scope of that term. As far as the Department's research reveals, the Indiana rule of statutory interpretation that the legislature is presumed, in passing a statute, to have been aware of other laws on the same subject, applies only to other statutes of the Indiana legislature, statutes of the United States, and reported opinions interpreting those laws. The Department has not found any reported Indiana opinion that has held that the rule also includes statutes of other states. Since the General Assembly cannot be presumed to have been aware of such laws, it follows that the Department has no duty to consider them in interpreting the Gross Retail and Use Tax Act.

Authority or lack of authority aside, if the definition of "tangible" were restricted to "perceptible by the unaided senses alone," applying that definition would, taken to its logical conclusion, lead to subjective, inconsistent, arbitrary and absurd results. Perceptible to whose unaided senses? Only to those of people with 20/20 vision? If that were the case, then packaging that includes printed, pictorial or other graphic material, would be tangible and taxable only to buyers and lessees with perfect eyesight who can see and read the package, but intangible and non-taxable to visually impaired buyers and lessees who cannot.

The taxpayer's distinction of the allegedly intangible copy of the program from the tangible packaging containing it does not advance its argument. Copies of the actual pre-written computer programs would be tangible and taxable if written in human-readable or "source code" form in a book or manual. However, if the copies were written on or copied to a disk in binary "object code" they would be intangible and non-taxable. This would be the case notwithstanding the fact that a computer—which, among other functions, acts as a sense-enhancing device—could read and execute the object code. The computer thereby enables the buyer or lessee not just to use that program, but also to see or (if the buyer or lessee has a sensory impairment) to at least experience it, in operation.

The taxpayer's thesis that things are intangible if they are incorporeal is thus unsustainable in fact, law, and application. The Department cannot administer the practical, workaday, nuts-and-bolts aspects of the Gross Retail and Use Tax Act on the basis of such metaphysical, what-is-real, how-many-angels-can-stand-on-the-head-of-a-pin distinctions. The only realistic way to administer these taxes is to apply a standard of tangibility that uniformly applies to every retail purchaser and lessee, regardless of the uncorrected sensory acuity of any given natural person. Defining "tangible" as meaning anything that can be perceived by any sense, aided or unaided, provides that standard.

2. Copies of "Canned" Software Are Not Intellectual Property, But Are Instead Tangible Personal Property.

i. Introduction—The Distinction Between Intellectual Property and a Copy of Intellectual Property

The taxpayer has also contended that the copies of the software programs in issue are intangible because they are intellectual property. It is clear to the Department from the Agreement that the transferor considered the programs to be trade secrets, both when it created them and when the parties entered into that agreement. However, the Agreement also states that the copies of the programs transferred to the taxpayer bore copyright legends. It is therefore unclear whether the transferor disclosed and published these programs, and if so to what extent and when publication occurred, or whether the programs remained unpublished and secret. However, if the programs did remain trade secrets, the taxpayer nevertheless had the right under the Agreement to, and in fact did, employ in its business the specific copies of the programs transferred to it. That action was a "use" as IC § 6-2.5-3-1(a) defines that word, and was also the taxable event that triggered liability for, and supported the auditor's assessment of, use tax. *See also Comptroller of the Treasury v. Equitable Tr. Co.*, 464 A.2d 248, 252-53 (Md. 1983) (holding that use of copies of software programs the court characterized as trade secrets nevertheless was a sale of those copies for sales tax purposes).

The taxpayer would also be liable if the copies of the programs in fact were, or became, protected by copyright, for the same reason. Copyright law draws an explicit distinction between a copyright and a copy, as the Department will explain below. That distinction also provides a complete response to the taxpayer's contention that Sales Tax Information Bulletin # 8 was an unauthorized expansion of the sales and use tax imposition statutes

ii. The Copyright Act of 1976, the Copyright-Copy Distinction and the Definition of "Copies"

In 1980, the General Assembly recodified the Gross Retail and Use Tax Act, chapter 30 (Special Session), 1963 Indiana Acts 60, into what is now IC article 6-2.5. Pub. L. No. 52, § 1, 1980 Ind. Acts 590, 590-620. Four years before that, Congress had recodified and updated the law of copyright in the Copyright Act of 1976, Pub. L. No. 94-553, Title I, § 101, 90 Stat. 2541, codified as Title 17 U.S.C. (1976 and Supp. III 1979). That act draws a distinction between a copyright and a copy in 17 U.S.C. § 202, which read in 1980, and still reads, as follows:

> *Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object;* nor, in the absence of an agreement, does transfer of ownership of a copyright or of any exclusive rights under a copyright convey property rights in any material object.

Id. (emphasis added by the Department), *quoted in Bernstein v. Glavin*, 725 N.E.2d 455, 460-61 (Ind. Ct. App.), *trans. denied* 741 N.E.2d 1248 (Ind. 2000). A copy thus is not the same as the copyright. Rather, a copy is the product of the idea the copyright memorializes.

A copy may consist of any substance and may be perceived with either the unaided or aided senses. The Copyright Act of 1976 defined, and still defines, "copies" as being

> *material objects*, other than phonorecords, in which a work is fixed by *any* method now known or later developed, and *from which the work can be perceived*, reproduced, or otherwise communicated, either directly or *with the aid of a machine or device*. The term "copies" includes the *material object*, other than a phonorecord, in which the work is first fixed.

17 U.S.C. § 101, *quoted in Williams Elecs., Inc. v. Artic Int'l, Inc.*, 685 F.2d 870, 877 (3d Cir. 1982) (first and last emphases added by the Department; all other emphases added by the court). Concerning this definition, the legislative history stated that "it makes no difference what the form, manner, or medium of fixation may be[.]" H.R. REP. NO. 94-1476, at 52, *reprinted in* 1976 U.S.C.C.A.N. 5659, 5665 *and in Williams Electronics*, 685 F.2d at 877 n.8. There is thus no distinction under copyright law between a copy of a computer program and a copy of any other copyrighted work, at least as far as the copyright owner's exclusive rights to reproduce and make the initial distribution of copies of that work are concerned. *See* 17 U.S.C. § 106(1) (granting the copyright owner the exclusive right to reproduce copies of the protected work). *See also* 17 U.S.C. §§ 106(3) and 109(a) (respectively granting the copyright owner the exclusive right to distribute copies of the protected work but permitting the lawful owner of a copy to sell or dispose of it without the copyright owner's authorization (commonly called the "first sale" doctrine)). As long as the copyright holder has authorized its creation and initial distribution (i.e., if infringement is not an issue), a copy is a copy is a copy.

At least one use tax opinion, *South Central Bell*, has used the copyright-copy distinction to indicate that it is the latter, and not the former, that is subjected to tax when canned software is involved. 643 So.2d at 1248. *See also Equitable Trust*, 464 A.2d at 252 n.5 (quoting 17 U.S.C.

§ 202 and observing in dicta that "[i]f the programs are in fact copyrighted, no intangible rights would be involved in the sale by the proprietors…." *Id.*). The United States Tax Court has also recognized the distinction as one justification for its holding copies of pre-written software to be tangible personal property eligible for the investment tax credit of I.R.C. (26 U.S.C.) § 38 (1988). *Norwest Corp. v. Commissioner*, 108 T.C. 358, 375 (1997), discussed in *First Data*, 639 N.W.2d at 902. (The present taxpayer's citing of Rev. Proc. 69-21, 1969-2 C.B. 303, as analogous authority supporting its position, is therefore misplaced. Rev. Proc. 69-21 deals with the expensing or amortization of a taxpayer's costs of developing software, not the investment tax credit for the price of copies of software already developed by someone else.)

ii. Effect of the Copyright-Copy Distinction and the Definition of "Copies" on Interpreting the Term "Tangible Personal Property" in the Gross Retail and Use Tax Act

Under the Indiana rules of statutory interpretation, a statute must be construed in the light of the factual and legal situation existing at the time of its enactment. *State ex rel. Glenn v. Smith*, 87 N.E.2d 813, 815 (Ind. 1949). The Copyright Act of 1976, which took effect on January 1, 1978, had been in effect for just over twenty-six months on the date of the Indiana sales and use tax recodification. *Compare* Copyright Act § 102, 90 Stat. at 2598 (setting January 1, 1978 effective date) *with* Pub. L. No. 52, § 1, 1980 Ind. Acts 590, 590 (showing act approved March 3, 1980) *and id*. § 6 at 621 (declaring the existence of an emergency and that the act took effect on passage). At that time the copyright-copy distinction had existed in case law and statute for over one hundred twenty-five years. *See generally Stephens v. Cady*, 55 U.S. (14 How.) 528, 529 and 531 (Dec. Term 1852) (respectively discussing the distinction and holding that a copyright of a map was not subject to execution, that the successful bidder at an execution sale of an engraved printing plate of the map did not also thereby acquire the copyright, and that the buyer should be enjoined from printing the map). *See also* Copyright Act of 1909, ch. 320, § 41, 35 Stat. 1075, 1084, formerly codified as 17 U.S.C. § 27 (1976) by the Copyright Act of 1947, ch. 391, § 27, 61 Stat. 652, 660. It is therefore reasonable to presume that the legislature, in recodifying the Gross Retail and Use Tax Act, was generally aware of the Copyright Act of 1976. It is also reasonable to presume that the it was aware in particular of the copyright-copy distinction, both historically and as codified in 17 U.S.C. § 202, and that the definition of "copies" in 17 U.S.C. § 101 drew no distinctions among lawful copies of the various kinds of copyrightable works.

Contemporaneous legislation, not precisely *in pari materia* (i.e., on the same subject), may be referred to in order to discern the intent of the legislature of the use of particular terms, or in the enactment of particular provisions. *Stout v. Board of Comm'rs of Grant County*, 8 N.E.222, 224 (Ind. 1886). "Statutes [also] are not to be considered as isolated fragments of law, but as parts of one great system." *Walgreen Co. v. Gross Income Tax Div.*, 75 N.E.2d 784, 785 (Ind. 1947) " 'Statutes are to be construed in connection and in harmony with the existing law and as a part of a general and uniform system of jurisprudence.' " *State Bd. of Accounts v. Indiana Univ. Found.*, 647 N.E.2d 342, 348 (Ind. Ct. App. 1995), quoting *Schwartz v. Castleton Christian Church, Inc.*, 594 N.E.2d 473, 476 (Ind. Ct. App. 1992). In light of the previously described state of copyright law, it is reasonable to presume that the General Assembly therefore would have understood, and intended, the phrase "tangible personal property" in the Gross Retail and Use Tax Act to exclude copyrights, but to include copies of the protected work capable of transfer from entity to entity, regardless of whether the copies could be perceived with the unaided or the aided senses.

iii. Sales Tax Information Bulletin # 8

In 1981, the year after the recodification of the Gross Retail and Use Tax Act and three years after the Copyright Act of 1976 took effect, the Department issued Sales Tax Information Bulletin # 8 (revised 1983, 1990 and 2002). In that bulletin the Department announced a policy of treating non-customized software as being tangible personal property, and therefore subject to Indiana gross retail and use taxes. However, the taxpayer was wrong to cite the original version of this bulletin as being the one in effect during the audit period. It is not the original Sales Tax Information Bulletin # 8, but rather the 1990 revision of this bulletin, that bears on this protest. That revision read in relevant part as follows:

> As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser.
>
> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the tact that the program may require some modification for a purchaser's particular computer. *Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.*

Id. at 3 (emphasis added). (The 2002 version of Sales Tax Information Bulletin # 8 repeats the above quotation with no change other than to formatting.)

The above-emphasized language makes it clear that Sales Tax Information Bulletin # 8 is consistent with the expansive definition of "copies" and the copyright-copy distinction found in 17 U.S.C. §§ 101 and 202, respectively. The Indiana legislature is legally presumed to have been familiar with both of these matters, for the reasons previously discussed above, and to have taken them into account in imposing taxes on the sale or use of "tangible personal property." It follows that the taxpayer is incorrect in asserting that the Department engaged in an unauthorized expansion of the sales and use tax imposition statutes in promulgating Sales Tax Information Bulletin # 8, including the 1990 version of that bulletin. In addition, although unnecessary to uphold the validity of that bulletin, it is significant that other jurisdictions, both before and after the Department promulgated the 1990 version and its above-quoted analogy of a copy of a computer program to a copy of other intellectual property, have judicially recognized the validity of such an analogy. *South Central Bell*, 643 So.2d at 1247; *Equitable Trust*, 464 A.2d at 254; *Hasbro Industries*, 487 A.2d at 128-29; *Chittenden Trust*, 465 A.2d at 1102. *See also Citizens and Southern Systems*, 311 S.E.2d at 718 (noting the trial court's use of the analogy).

Contrary to the taxpayer's assertion, it is not entitled to have the term "tangible personal property" construed in its favor and against the Department. That term, in light of the above-described legal context in which it was enacted, is not ambiguous. Since there is no ambiguity, the rule of statutory interpretation that tax imposition statutes must be construed in favor of a taxpayer and against the Department does not apply.

FINDING

The taxpayer's protest is denied as to this issue.

II. Gross Retail and Use Tax—Retail Unitary Transactions—"Pre-Written," "Canned" or "Off-the-Shelf" Software

A. THE TAXPAYER'S ARGUMENT

The taxpayer contends that assessing use tax on the copies of the software is invalid because the physical media on which the software was transferred to it were not the essence or true object of the transaction. It argues that object was to license the allegedly intellectual, intangible, incorporeal property constituting the canned software programs, rather than to acquire the tangible, corporeal media on which they were recorded and stored. The taxpayer has not cited any authority in support of its argument. However, that argument clearly refers to the "true object" test set out in *Cowden & Sons Trucking, Inc. v. Indiana Department of State Revenue,* 575 N.E.2d 718, 724 n.5 (Ind. Tax Ct. 1991), and the opinions there discussed. The Department will refer in the following Discussion to additional details of the taxpayer's argument if and as needed.

B. THE INDIANA COURTS HAVE NOT HELD THAT THE "TRUE OBJECT" TEST OR UNITARY TRANSACTION ANALYSIS APPLY TO MIXED TRANSACTIONS OF GOODS AND INTELLECTUAL PROPERTY.

The taxpayer bases its argument on two unstated assumptions: first, that the "true object" test applies to mixed transactions of intellectual property and tangible personal property, and second, that the transaction in issue in this protest is such a transaction. Neither of these assumptions is correct.

The Indiana courts developed the "true object" test to analyze the gross income tax or sales and use tax consequences, and the Department promulgated 45 IAC § 2.2-4-2 to analyze the sales and use tax consequences, of mixed or unitary transactions that include goods and services. However, since the Department did not propose to levy use tax on the consulting services the transferor rendered the taxpayer, there is no factual foundation for applying either the "true object" test or unitary transaction analysis to the copies of the software alone. There is certainly no legal basis for doing so, even if the content of the copies is protected intellectual property. As far as the Department's research shows, the Indiana courts have never applied the "true object" test or unitary transaction analysis to such goods. Nor could either the "true object" test or 45 IAC § 2.2-4-2, according to their literal terms, apply to such a transaction, since a service is different from the intellectual property of which a copyright, patent or trade secret consists. " 'To be a service, work must be performed for the benefit of a particular customer. Designing a generally marketable product is not a service because the cost of design is spread among all customers, and their identity is unknown at the time the product is designed.' " *Hasbro*

Industries, 487 A.2d at 128 n.5, quoting Robert L. Cowdrey, Note, *Software and Sales Taxes: The Illusory Intangible*, 63 B.U. L. REV. 181, 212 (1983).

C. THE TRANSFERS OF THE SOFTWARE COPIES IN ISSUE ARE NOT MIXED TRANSACTIONS OF GOODS AND INTELLECTUAL PROPERTY.

Even if the "true object" test or unitary analysis did apply to such transactions, however, the transfers in issue in this protest are not of that type. The Copyright Act of 1976 includes a statute of frauds that governs copyright transfers. "A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent." 17 U.S.C. § 204(a), *quoted in Bernstein*, 725 N.E.2d at 459. *See generally* 17 U.S.C. § 101 (defining "transfer of copyright ownership"). " 'The rule is really quite simple: If the copyright holder agrees to transfer ownership to another party, that party must get the copyright holder to sign a piece of paper saying so. It doesn't have to be the Magna Charta; a one-line pro forma statement will do.' " *Id.* at 460, quoting *Effects Assocs., Inc. v. Cohen*, 908 F.2d 555, 557 (9th Cir. 1990). For example, language transferring " 'all right, title and interest…in and to all programs and software' " is sufficient. *Shugrue v. Continental Airlines, Inc.*, 977 F. Supp. 280, 285-86 (S.D.N.Y. 1997), *quoted in Bernstein*, 725 N.E.2d at 460. However, there is no language whatever in the present Agreement, simple or elaborate, indicating that the transferor of the copies of the software also intended to transfer, or that the taxpayer intended to acquire, any interest in the software copyrights or trade secrets (if they were trade secrets) of which the copies were examples.

Therefore, the taxpayer's "true object" test argument fails by virtue of what the Department has said previously on the legal distinction between a copy of intellectual property and the property itself. It follows from this distinction that if the "true object" test applies at all, then the object of the present transaction was to transfer property interests in the copies of the software, not any ownership rights in the programs copied. This result is consistent with those reached by courts that have rejected taxpayers' arguments that under the applicable test, however described, the point of a transaction in copies of software is the transfer of intellectual property. *South Central Bell*, 643 So.2d at 1246-47 ("essence or real object of the transaction"); *Chittenden Trust*, 465 A.2d at 1101-02 ("focus of the transaction"); *Pennsylvania and West Virginia Supply*, 368 S.E.2d at 104 ("essence of the transactions").

The fact that the Agreement uses license terminology is not to the contrary. "[T]he license to use the software, without transferring the software, would be of no use to [the taxpayer], and the license to use the software is inseparable from the physical manifestation of the software in recorded form." *South Central Bell*, 643 So.2d at 1249. In this federal circuit, whatever the effect of license language in a software agreement might be in an intellectual property dispute, for day-to-day legal purposes the subject of such contracts is treated, as between the parties, as being goods. *See ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1450 (7th Cir. 1996) (holding software "shrinkwrap" licenses to be enforceable under the common law of contract and the Uniform Commercial Code ("U.C.C.")), citing *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994). This position is consistent with those of opinions of other courts that have held canned software to be goods subject to U.C.C. Article 2, which governs the sale of goods. Those opinions include: *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 546-47 (9th Cir. 1985); *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291, 1293 n.5 (5th Cir. 1980); *Colonial Life Ins. Co. v. Electronic Data Sys. Corp.*, 817 F. Supp. 235, 238-39 (D. N.H. 1993); *Aplications,* [sic] *Inc v. Hewlett-Packard Co.*, 501 F. Supp. 129, 133 (S.D.N.Y. 1980), *aff'd* 672 F.2d 1076 (2nd Cir. 1982); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 479 F. Supp. 738, 742-43 (D. N.J. 1979), *aff'd and remanded* 635 F.2d 1081 (3rd Cir. 1980); *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39, 44-45 (D. S.C. 1974); *Neilson Bus. Equip. Ctr., Inc. v. Monteleone*, 524 A.2d 1172, 1174 (Del. 1987); *Austin's of Monroe, Inc. v. Brown*, 474 So.2d 1383, 1388 (La. Ct. App. 1985); *USM Corp. v. Arthur D. Little Sys., Inc.*, 546 N.E.2d 888, 894 (Mass. Ct. App. 1989); *Communications Groups, Inc. v. Warner Communications, Inc.*, 527 N.Y.S.2d 341, 343-44 (N.Y. Civ. Ct. 1988); and *Camara v. Hill*, 596 A.2d 349, 351 (Vt. 1991).

D. IT WOULD BE IMPOSSIBLE AND UNDESIRABLE TO APPLY THE "TRUE OBJECT" TEST OR UNITARY TRANSACTION ANALYSIS TO TRANSACTIONS OF GOODS DESIGNED FROM INTELLECTUAL PROPERTY.

There are two additional reasons why it would be impossible to apply the "true object" test or 45 IAC § 2.2-4-2 to transactions involving copies of computer software. Under either the "true object" test or unitary transaction analysis, it is at least possible to separate and quantify the goods and services elements of a transaction, although it often does not occur in fact. However, it is impossible to do so as between the raw materials and the intellectual property components of a copy of that property: As *South Central Bell* noted regarding software in particular:

> One cannot escape the fact that software, recorded in physical form, becomes inextricably intertwined with, or part and parcel of the corporeal object upon which it is recorded, be that a disk, tape, hard drive, or other device.…That the information can be transferred and then physically recorded on another medium is of no moment, and does not make computer software any different than any other type of recorded information that can be transferred to another medium such as film, video tape, audio tape, or books.

643 So.2d at 1247. Even if such a separation were possible, however, giving it administrative or legal recognition would have a devastating effect on the sales and use tax laws. As stated in *Equitable Trust*:

> There is scarcely to be found any article susceptible to sale or rent that is not the result of an idea, genius, skill and labor applied to a physical substance.…If these elements should be separated from the finished product and the sales [or use] tax applied only to the cost of the raw material, the sales [and use] tax act would, for all practical purposes, be entirely destroyed.

464 A.2d at 258, quoting *Crescent Amusement Co. v. Carson*, 213 S.W.2d 27, 29 (Tenn. 1948).

FINDING

The taxpayer's protest is denied as to this issue.

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